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FINANCIAL CONSULATE™

The Biggest Investor Mistake

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No doubt, there is one mistake most investors make. It is not selling too soon. Nor is it is not buying too early. It isn't paying too much in taxes or being too emotional. The biggest mistake most investors make is simply trying to make money.

How could making money be a mistake? After all, is that not the very reason to invest? Of course not!

Does Warren Buffett invest to make money? No! He invests, because he enjoys being a capital allocator. He invests, because like any good steward, he cares for his assets prudently. So, if this is the case, how does he make a great rate of return if he does not try to make a high rate of return?

Great investors are always risk managers and not return managers. Great investors avoid losing money by allocating the right amount of capital to good businesses run by good people. A bad company run by bad people will go bankrupt in a couple of years. A bad business run by good people will go bankrupt in ten years. A good business run by bad people will be mediocre for a few decades, but a good business run by good people will be exceedingly profitable forever.

Losing money is far easier than making money. If you invest $1000 and lose 50%, you are left with $500. A 50% loss required a 100% gain to get back to even. Too often investors chase the great "ten baggers" (1000% return) and almost always end up with fifty cents.

Risk is determined by the price you pay for the asset you get. Risk is often mistakenly considered to be volatility. Emerging Markets are volatile and therefore are considered risky, but if the investment is bought at a good price, there is very little risk. Blue Chips are not as volatile and therefore considered less risky, but bought at the wrong price they are very dangerous. Does the year 2000 ring a bell to anyone?

You have the opportunity to be a great investor when you manage risk and learn how to buy good assets at good prices. Here are some steps to take when buying a stock:

1) What is the cost of the company if you were to buy the whole company? This is all stock outstanding plus debt.

2) If you had that much money, this a great price per share for the assets and cash flow you are getting?

3) Is this a great price if a few bad things happened, for example, sales were to slow, or they lose a big a customer, etc?

4) What is the value of the people and goodwill (its name and reputation) of this company?

If your conclusion is that this is a good company at a great price per share, then buy the stock. If not, then be patient and keep looking until you find a good company at a great price. Patience is the greatest tool in a risk manager's tool box. Have you noticed that for the last ten years, Warren Buffett is sitting on multiple billions of dollars just waiting to buy? You too should learn to be patient, for those eager to be rich will find that only poverty awaits. Those who are content with what they have and carefully steward there small resources will one dav wake to find a fortune.